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UNCLAS SECTION 01 OF 02 LILONGWE 000283

SIPDIS

SENSITIVE

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E.O. 12958: N/A

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SUBJECT: MALAWI KWACHA UNDER SPECULATIVE PRESSURE

REF:

This message is sensitive but unclassified--not for Internet distribution.

SUMMARY

[1](#)1. (U) Malawi's banks are reporting a surge in demand for foreign currency. Experts attribute the surge to speculation that the GOM may devalue the currency as the tobacco auction starts on March 29 or shortly afterward. The governor of the central bank has given no clear signals, though it appears the bank has adequate cover to maintain the Kwacha until import revenues begin to flow. End summary.

HIGHER DEMAND, THIN RESERVES

[1](#)2. (SBU) Over the past several weeks, commercial banks here have tightened their restrictions on foreign currency in the face of noticeably higher demand. Industry analysts report that some customers expect a devaluation of the Kwacha as the tobacco auction floors open on March 29. Such a move would be popular, as it would effectively remove the black-market premium farmers are paying for an artificially high Kwacha. (The parallel rate for the Kwacha has climbed in recent months from about MK116/USD to as high as MK125/USD, while the official rate has stayed at about MK110/USD.) The speculation has spurred higher demand for foreign currency as importers and holders of foreign currency denominated loans rush to pay early.

[1](#)3. (SBU) Both official and commercial reserves are thin, at about 1.4 months of coverage (at historically average levels of demand), but are likely adequate to maintain the Kwacha over the next few weeks. This level of forex reserve is far below the target 3 months, but slightly above the 1.3-month average since December 2004. Foreign exchange availability is highly seasonal in Malawi, flowing freely April to September, when tobacco markets are open, and drying up October through March. During the periods of scarcity, importers and other forex users usually do not have immediate access to foreign currency.

TOO CLOSE FOR COMFORT?

[1](#)4. (SBU) Up to now, the Reserve Bank of Malawi (RBM) has provided no signals to the market. The new governor has told us he would like the currency to float more freely, but few observers believe he will defy President Mutharika's public promise not to devalue the Kwacha. (Interestingly, the governor did not have an agreement on this question before he accepted the job.) At this point, it is difficult to say where the threshold of discomfort lies, and how few reserves--or how vigorous an attack--would trigger a devaluation. For the moment, anything near 1.5 months of coverage each for official and commercial reserves seems comfortable enough.

[1](#)5. (SBU) On the other hand, several factors point to a possible devaluation. The RBM recently announced that it will no longer buy dollars on the tobacco auction floor, which removes a major lever it has used against speculative behavior on the part of commercial banks. Without direct (forced) access to foreign currency, the RBM must now depend on the banks' good behavior. Secondly, pressure is mounting from high global petroleum prices, from which the GOM has been (unsustainably) shielding its consumers. Finally, the black market premium on the Kwacha is causing exporters to complain ever more loudly that they cannot maintain export volumes at an artificially low rate of return.

COMMENT

16. (SBU) The RBM is caught in a difficult position, with mounting pressure to devalue but equal or greater fiscal pressure to hold on at least until the International Monetary Fund has put a new funded program in place. The IMF's decision has been delayed because of the possible budgetary impact of emergency food imports, which means new donor inflows are unlikely before August. Add to that a lean budget and a low IMF ceiling on inflation, and the incentive to hold on is clear. But with the prospect of tobacco earnings for the next several months, followed quickly by new donor money, the RBM is clearly tempted to release a little pressure now, while the release may still be controllable.

GILMOUR